

QUANTIFICATION OF THE IMPACT OF CORRUPTION ON THE EXTENT OF TAX EVASION IN ROMANIA

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Abstract: *The target of this paper is to highlight the interaction between fiscal policy, tax evasion and corruption in the context of a corrupt economic and social environment. Having these considerations in view, we have assumed that the probability that a corrupt official in the tax administration is properly controlled and sanctioned by the workers of the anti-corruption division is minimal (tends to zero), so it can be considered negligible. This encourages the increase in the number of corrupt officials and the proliferation of tax evasion, which makes the possibility for a tax escapist to be checked and discovered by a corrupted officer in the control apparatus to be very high*

Keywords: corruption, economic development, tax evasion.

JEL Classification: E26

Corruption is delaying economic development, hampering democratic processes, and seriously affecting justice and the rule of law. None of the European states is protected from the effects of this phenomenon.

According to Transparency International, the Corruption Perceptions Index (CPI) is a global aggregate index of up to 12 different sources that captures the perceptions of business people and country experts about the level of corruption in the public sector. Country scores reflect the perceived level of corruption: 100 points means not corrupted at all while 0 points account for a very corrupted state.

In Romania, CPI was first calculated in 1997 to be included in the National Anticorruption Strategy in 2012 as a performance indicator. Romania set a goal for 2015 to score 63 points - equal to the EU average.

IPC 2015 ranks Romania 58th in the top of the world, with a score of 46 points, compared to an average of 65.36 points in the European Union. Although progress is not substantial compared to last year, Romania's sustained efforts in the fight against corruption are beginning to be visible in the evolution of country indices.

In 2014, Romania earned only 43 points and was ranked only 69th among the world's states, so this year there will be a 9 place rise in the ranking. It is also worth mentioning that in 2015 it is the first time in the last years when the Index for Romania is in an ascending trend.

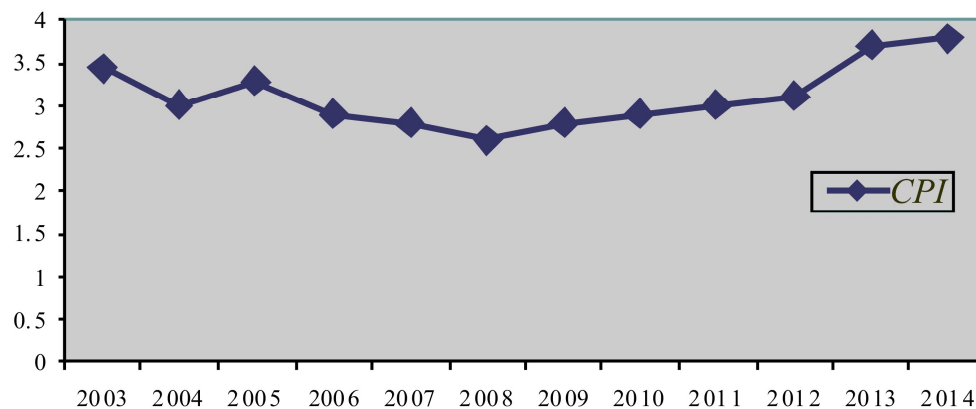
The level of corruption is symptomatic of general economic, political and social development, and its manifestation is detrimental to public ethics and morals and undermines public confidence in the rule of law.

In Romania, we witness an infiltration of corruption in areas that should support the country's economic development. Firms in more and more spheres of activity are pushed into the underground economy. The immediate effect of this situation is reflected in a vicious circle where endemic corruption leads to a fall in public revenues and investment and weakens the credibility of the rule of law. It also generates negative changes in economic development through inefficient, slow and sometimes unreasonable transactions, altering capital accumulation and productivity, government revenue, and the quality of public infrastructure.

In our country, anti-corruption measures emerge when there is a violation of legal norms, but the resulting consequences are not very serious, but rather have the potential to generate corruption, rather than to constitute acts of corruption per se. This category includes administrative inspections, audit work, control bodies, etc. Penalties occur when the acts of corruption have already occurred, the consequences have been ascertained, the only possible interference that may be taken is the criminal sanctioning of the culprits in order to avoid the perpetuation of these facts and to form a pattern of specific consequences situations, for the rest of society¹.

The proliferation of corruption offenses and the lack of real sanctions is strongly felt by the ordinary citizen, as evidenced by the evolution of the Corruption Perceptions Index lately.

Figure 1 – Evolution of the Corruption Perception Index in Romania (2003 - 2014)



Source: Transparency International Romania - National Report on Corruption 2015

The target we are now setting is to highlight the interaction between fiscal policy, tax evasion and corruption in the context of a corrupt economic and social environment. In view of the above considerations, we have assumed that the probability that a corrupt official in the tax administration is properly controlled and sanctioned by the workers of the anti-corruption division is minimal (tends to zero), so it can be considered negligible. This encourages the increase in the number of corrupt officials and the proliferation of tax evasion, which makes the possibility for a tax evader to be checked and discovered by a corrupt officer in the control apparatus to be very large.

¹ Transparency International România – National Report on Corruption 2014.

In order to determine the probability of detecting tax evasion, we reported the number of checks made to the number of potential taxpayers. We considered potential contributors to the entire busy population, on the assumption that the individuals who are a part of it must contribute, one way or another, to the formation of the state's tax revenues.

Taking into account the elements outlined in the previous chapter, we have identified the situations in which a taxpayer with a neutral risk aversion, unaware of the source (legal or illegal) of the income obtained, can be found. In the case of a taxable average income (V) and a single tax rate (i), the taxpayer who builds a circumvention strategy has the following options:

1. performs tax evasion, but is not discovered, situation characterized by probability $(1-p)$. In this case, the taxpayer's earnings are $X = V(1-p)$;

2. performs tax evasion and is discovered by an honest official, a situation characterized by probability (pq) . In this case, the taxpayer's earnings are $X = pq[V - iV(a + 1)]$, where q - the probability of the official being honest, i - the tax rate and a - the penalty rate;

3. Makes tax evasion and is discovered by a corrupt clerk, to whom he pays a bribe (m), calculated as a percentage of the amount of tax and penalties owed, a situation characterized by the probability $[p(1-q)]$.

In this case, the taxpayer's earnings are $X = p(1-q)[V - miV(a + 1)]$;

As a result, the winning escaping outcome will be:

$$X = V(1-p) + pq[V - iV(a+1)] + p(1-q)[V - miV(a+1)]$$

Including the premise that there will always be corrupt officials in Romania who are interested in obtaining undue benefits, and that the likelihood of meeting such an official is very high, I will attribute to q (the probability of the official being honest) 0. In these circumstances, the taxpayer's earnings resulting from the avoidance strategy will be:

$$X = V(1-p) + p[V - miV(a+1)]$$

For a fairly approximate estimation of the Romanian taxpayer's earnings as a follower of the avoidance strategies, we will use the data presented in Table 1 for the period 2008-2013.

Assuming a single income tax rate of $i = 16\%$ (single rate of income adopted in 2005) for the entire period considered and a bribe amount equal to a certain percentage of the amount of tax and penalties due under normal and fair compliance of the taxpayer, the average earnings resulting from the avoidance strategy compared to the safety income (the average taxable income minus the tax due) is shown in Table 1 and Figure 2.

Table 1: The probability of detecting tax evasion, the sanction rate and the average taxable income of a taxpayer between 2008 and 2013

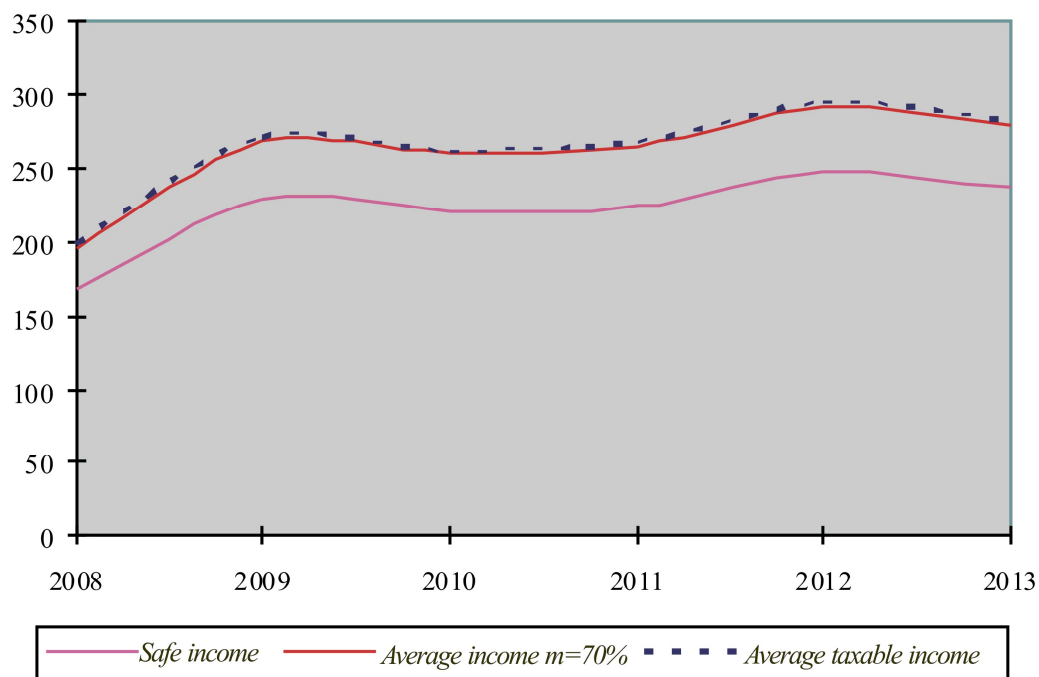
Indicators	Number of checks	Potential taxpayers (thousands persons)	Probability to detect tax evasion	Average taxable income of a taxpayer 2003 = 100 (thousand lei)	Rate of sanctioning identified evasion tax
Years					
2008	446822	9223	0.048	198.77	2.2590
2009	273020	9158	0.030	271.45	2.0202
2010	286903	9147	0.031	262.38	0.6513
2011	252719	9313	0.027	267.44	1.5975
2012	276853	9353	0.030	294.21	1.6625
2013	287280	9369	0.031	282.04	1.4475

Source: National Institute of Statistics - Statistical Yearbooks; National Agency for Fiscal Administration (NAFA) - Information on the results of the control bodies regarding the identification and combating of tax evasion and own calculations.

Table 2: Average earnings resulting from the avoidance strategy

Indicators	Average taxable income of a taxpayer 2003 = 100 (thousand lei)	Safety income 2003 = 100 (thousand lei)	Average income resulted from the avoidance strategy 2003 = 100 (mii lei) m=30%	Average income resulted from the avoidance strategy 2003 = 100 (mii lei) m=50%	Average income resulted from the avoidance strategy 2003 = 100 (mii lei) m=70%
Years					
2008	198.77	166.97	197.27	196.26	195.26
2009	271.45	228.02	270.27	269.49	268.71
2010	262.38	220.40	261.73	261.29	260.86
2011	267.44	224.65	266.54	265.93	265.33
2012	294.21	247.14	293.10	292.36	291.61
2013	282.04	236.91	281.02	280.35	279.67

Source: own calculations

Figure 2 – Avoidance strategy – Comparative evolution of incomes

In conclusion, the average earnings resulting from an eluding strategy is close to the average level of the pre-tax income obtained by the Romanian taxpayer.

By generalizing the rationale at the level of all potential taxpayers, we estimated the influence of corruption on the process of identifying tax evasion. In this respect, we determined the weight of tax evasion identified as a result of controls in the general gains resulting from the avoidance strategy (Table 3).

Table 3: The share of tax evasion unidentified in the total tax evasion

Indicators	Identified tax evasion 2003 = 100 (thousand lei)	Average revenue of population due to avoidance strategy 2003 = 100 (thousand lei) m=50%	Share of identified tax evasion in earnings resulted from avoidance strategy (%)	Tax evasion protected by corruption (%)
Year				
2008	798900.00	1794014.73	44.53	55.47
2009	982350.00	2455330.00	40.01	59.99
2010	1511951.52	2382997.24	63.45	36.55
2011	1167519.35	2466029.20	47.34	52.66
2012	1275399.44	2721471.30	46.86	53.14
2013	2389026.10	2614392.10	91.38	8.62
Average value during 2008- 2013				44.40

Source: own calculations

According to the calculations, more than half of the value of the tax evasion is discovered, the rest (44.4% of the earnings resulting from the avoidance strategy) being in the shelter provided by the corruption of state officials.

Of course, the model presented is subjective, very approximate and involves a whole range of prerequisites and conditions. However, the conclusion that can be drawn is that in a corrupted environment, the avoidance decision is dependent on the likelihood of detection, the penalty rate and the bribe rate, in a ratio inversely proportional to the volume of tax evasion, and the identified level of the latter is inferior to its real level, which is impossible to determine due to corruption. Each monetary unit paid in the sphere of corruption implies its recovery accompanied by an illicit advantage, superior to the revenues that could be obtained legally. As a result, corruption is one of the causes of the proliferation of the underground economy, exerting a multiplier effect on the level of fraud.

Starting from the supposition that the private sector plays a key role in shaping the way in which society responds to the phenomenon of corruption, and that a clean, integral and transparent business environment can contribute decisively to Romania's development, TI-Romania's immediate response to the CPI outcome is launching the Corporate Integrity Certification Program. The program is based on the commitment recently assumed by the Chamber of Commerce and Industry of Romania, and involves a three-step conjugal effort, which starts from the formulation of a commitment to values and principles adapted to the organizational culture of each company. At the second level, the program continues with the construction of the operational framework for the implementation of the ethics and compliance management system, so that the company's investment in assuring integrity on its distribution and supply chain is at the bottom. A fourth transversal component is the development of the verification system, self-assessment and mitigation of the risks of lack of integrity. Under this program, TI-Romania will provide companies with technical assistance for the three steps, at the end of which they will publicly certify the existence of the internal mechanisms necessary to prevent the occurrence of integrity incidents. At the same time, consistent with its commitment to an honest Romania without corruption, Transparency International Romania aims to devote its expertise and energy during the following five years to:

→ Guide people's attitude and mentality towards the development of a social culture of integrity - through anti-corruption legal training and counseling programs for victims, witnesses and integrity alerts

→ Develop ethics and anti-corruption programs for the business environment, promoting integrity standards in line with international and European best practices

→ Develop sustainable programs for strengthening the anticorruption capacity of public institutions by making use of existing expertise at their level and multiplying good practices validated by the Romanian public administration

→ Strengthen Romania's position in the region and at international level as a source of good practice on efforts and determination to combat corruption through judicial means, and judicial corruption itself.

Conclusions

Recourse to tax evasion practices is based on the taxpayer's system of values, beliefs and morals, but also on the conduct and the economic and social environment to which he belongs. The possibilities of circumvention differ from one social category to another

depending on the nature or provenance of the wealth subject to taxation, the way in which the taxable material is determined, the way in which control is organized, etc. The level of corruption may be symptomatic for general economic, political and social development. All forms of corruption also harm public ethics and morals and undermine the trust of the population in the rule of law. An obstacle in the way of social and economic development, corruption deepens poverty, prevents proper provision of basic public services and undermines democracy. The competition based on price, demand and supply is replaced by a competitive bribery process, damaging to all countries, which have to cope with the extraordinary challenge of strategies to reduce corruption and diminish state seizure.

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